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May 2, 2014

PSC STAFF OPINION 2014-006

Mr. Scott Sparks
Vice President Operations & Maintenance
Forge Group North America
221 Business Street
Beckley, WV 25801

Re: Utility Recovery of Costs for Coal Yard Operations Performed by a Contractor

Dear Mr. Sparks:

Commission Staff acknowledges receipt of your April 22, 2014 email in which you request an opinion concerning whether costs for outsourcing coal yard operations at coal-fired utility plants are 100% recoverable by a utility that contracts out the services. This letter represents Commission Staff's interpretation of the law as applied to the facts presented. This opinion is advisory in nature and not binding on the Commission should the issues herein be formally presented for Commission resolution.

Based upon your email, Commission Staff understands the facts as follows: Your company, Forge Group North America ("Forge Group"), provides engineering, procurement, construction and asset management in the minerals and minerals-processing business, including coal-fired utilities. Forge Group is considering expanding its operations into other markets. Forge identified one area of expansion as coal yard operations at coal-fired utility plants. Under this model, utilities with coal-fired plants would outsource the management of their coal yard operations to Forge Group.

Your email presents the following question: If utilities outsource the coal yard operations to Forge Group, are the costs incurred by the utilities under such contracts 100% recoverable.

Reasonable costs incurred by a utility to provide service may be recovered through rates prescribed by the Commission pursuant to its statutory authority set forth in KRS Chapter 278. KRS 278.030 governs the rates a utility may receive for service furnished. KRS 278.030(1) provides that, "Every utility may demand, collect and receive fair, just and reasonable rates for the services rendered or to be rendered by it to any person." Kentucky courts define "fair, just and reasonable" rates as those rates that "enable the utility to operate successfully, to maintain

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its financial integrity, to attract capital and to compensate its investors for risks assumed.” *Commonwealth of Ky. Ex rel. Stephens v. South Central Bell*, 545 S.W.2d 927, 930 (Ky. 1976) (citing *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)).

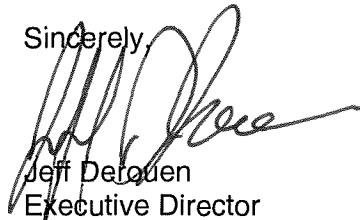
Operating costs are one of the many factors the Commission must consider in determining the reasonableness of a utility's rates. *National Southwire Aluminum Co. v. Big Rivers Electric Corp.*, 785 S.W.2d 503, 512 (Ky. App. 1990). In exercising its statutory authority to ensure that rates are fair, just, and reasonable, the Commission must consider a fundamental principle of utility rate-making: The lowest possible cost to the ratepayers. *Public Service Comm'n v. Continental Tel. Co.*, 692 S.W.2d 794, 799 (Ky. 1985). There is no provision in KRS Chapter 278 that prohibits a utility from outsourcing to contractors any of the functions that must be performed to provide service. Thus, a utility may choose to have all aspects of its service performed by employees of the utility, or a utility may choose to outsource certain functions to contractors working for the utility. Irrespective of how a utility chooses to provide service in filing an application to adjust rates, the utility has the burden of proof to show that its costs are reasonable and necessary for the service it provides. KRS 278.190(3).

Although this staff opinion concludes that a utility may recover in rates the lowest reasonable costs necessary to provide service, the reasonableness of a particular cost can only be determined on a case-by-case basis after the Commission has conducted an investigation of all relevant factors in a rate case.

Your email indicated that you have requested this opinion to further develop your firm's marketing strategy, as well as completing your presentations to the utility customers regarding outsourcing coal yard operations. Due to the myriad of factors that must be considered by a utility in determining whether to outsource a particular aspect of its operations, Commission Staff is not able to provide an opinion as to whether or not a utility would be entitled to full recovery of its costs to outsource coal yard operations.

This letter represents Commission Staff's interpretation of the law as applied to the facts presented. This opinion is advisory in nature and is not binding on the Commission should the issues herein be formally presented for Commission resolution. Questions concerning this opinion should be directed to Nancy Vinsel, Staff Attorney, at (502) 782-2582.

Sincerely,



Jeff Derouen
Executive Director

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